

**BEFORE THE POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001**

**Regulations Establishing System
of Ratemaking**

Docket No. RM2007-1

**INITIAL COMMENTS OF PITNEY BOWES INC.
IN RESPONSE TO ADVANCE NOTICE OF PROPOSED RULEMAKING
ON REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING**

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I. INTRODUCTION

In 2002 a joint industry-Postal Service task force identified the mailing community as a \$900 billion industry, employing 9 million workers, and comprising 8 percent of the Nation's Gross Domestic Product.¹ The enactment of the Postal Accountability and Enhancement Act of 2006 ("PAEA" or "Act")² begins a new era for this community.

The PAEA assigns substantial responsibility to the Postal Regulatory Commission (the "Commission") and the United States Postal Service (the "Postal Service") with respect to the establishment of a modern postal regulatory system. Each must promulgate regulations, conduct reviews, develop plans, and issue reports. Their actions will determine whether the new system ensures the continuation of the universal, affordable mail service that the Nation has come to expect, but which many believe is threatened today.³

In Docket No. RM2007-1, Advanced Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking ("ANPRM"), the Commission takes the first step in fulfilling its responsibility to "by regulation establish . . . a modern system for regulating rates and classes for market dominant products." It also begins the process of promulgating "regulations to bound Postal Service discretion in setting rates for competitive postal products."

¹ See Mailing Industry Task Force Fall 2002 Progress Report, dated September 23, 2002.

² Pub. L. No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). Many provisions of the PAEA amend title 39 of the United States Code. In these comments section references are to sections of title 39 unless otherwise noted.

³"Congress reaffirmed the Postal Service's role as a government service, whose primary mission remains providing universal service at affordable rates for the American public." Commission Chairman Dan Blair, Remarks at the Summit Meeting – Postal Customer Needs in a Changing Regulatory Environment, March 13, 2007 (Tr. 1/3) <<http://www.prc.gov>> ("Blair Summit Comments"); "The business model is, was, is broken. And, we have had some good success in the last couple of years. But, it masks the fact that the underlying premise upon which this model was built, which is that growth and volume combined with rate increases at the rate of inflation will finance universal service to a growing population. That model, simply stated, has broken." Postmaster General John E. Potter, Remarks as the at the American University School of Public Affairs's Forum on Postal Reform, March 1, 2007, transcript at 24; see also GAO-07-310, *High Risk Series An Update*, p. 9 (Jan. 2007)(observing that in 2001 the Government Accountability Office had designated the Postal Service as a "high risk" because its financial outlook had deteriorated substantially).

Many additional proceedings will follow.⁴ This one, however, is of particular importance because it will determine the role the Commission will play in the implementation and administration of the modern ratemaking system required by the PAEA.

In the PAEA Congress deferred to the Commission the difficult task of reconciling competing or sometimes conflicting policies. Pitney Bowes Inc. (“Pitney Bowes”) suggests that the Commission has an obligation under the statute to play a very active role in the implementation and administration of the modern postal ratemaking system. Through its implementing regulations, the Commission should provide advance guidance about the requirements and boundaries of the new system so that stakeholders will have confidence as to the rules that will apply. Failure to enunciate clear principles and, where necessary, prescribe rules in advance will lead to confusion, uncertainty, and otherwise avoidable litigation. Providing clear guidance in advance will also promote the flexibility and predictability goals of the statute and encourage future investment in the mailstream.

II. MODERN RATEMAKING FOR MARKET DOMINANT PRODUCTS

In developing this modern ratemaking system, Pitney Bowes respectfully suggests that the Commission adhere to the following guidelines.

Embrace the Letter and Intent of the Statute. The PAEA gives the Commission substantial authority and discretion in many respects, but the statute also provides substantial

⁴ Chairman Blair identified other regulatory proceedings which could be coming in short order:

We’re going to have to reissue the basic rules of practice for the Commission. We’re going to have to issue rules for the handling of sensitive documents required by annual reports or obtained through the [UI] Subpoena Authority. We’ll have to establish rules for establishing periodic reporting requirements to support the annual reports, rules for complaints, regulations to prevent unfair competitive advantages for the Postal Service, rules for the Commission, Postal Service, or third party to initiate changes to any regulations or statutes. We’ll have, regulations will be needed to govern the recent maintenance of the reserved area. Regulations applicable to market tests; and the lists go on.

Commission Chairman Dan Blair, Remarks at the American University School of Public Affairs’s Forum on Postal Reform, March 1, 2007, transcript at 13-14.

Congressional direction. In its ANPRM the Commission identifies the statutory objectives, factors, and requirements the PAEA prescribes for the modern rate regulation system of market dominant products. Pitney Bowes suggests the Commission should, through its regulations, ensure that the modern ratemaking system *achieves* the statutory *objectives*, *takes into account* the enumerated *factors*, and *satisfies* the statutory *requirements*. The Act’s objectives, factors and requirements should be balanced to enhance the value of mail as a vital communications medium and promote a vibrant, growing mailing industry.

Promote Reduced Costs and Improved Efficiency through Rules and Incentives. The Act’s first stated objective, “to maximize incentives to reduce costs and increase efficiency,” should serve as the cornerstone of the modern ratemaking system. 39 U.S.C. §3622(b)(1). Under the PAEA, the Postal Regulatory Commission is directed to design a system that will improve efficiency and control costs.⁵ No other objective better serves to promote and sustain a vibrant, growing mailing industry, enhance the value of the mailstream, and ensure universal, affordable mail service.

A ratemaking system that lowers the total postal sector costs is the best means to reduce costs and increase efficiency. Through its regulatory power, the Commission should seize this unique opportunity to build upon its recent decisions recognizing the importance of Efficient Component Pricing (“ECP”). As the Commission observed in its most recent Opinion and

⁵ “Under the new system, the Postal Regulatory Commission will have the flexibility to design a system that will improve efficiency and control costs. The details of such a system have been left to the Commission so that this regulatory body will be able to respond to changes in mail volume, technologies, and other factors.” H.R. Rep. No. 109-66, 109th Cong., 1st Sess., Part 1 (Apr. 28, 2005)(“2005 House Report”) at 48. There are no committee reports accompanying H.R. 6407 (109th Cong., 2d Sess.), the bill that ultimately became the PAEA. There are committee reports accompanying earlier versions of postal reform legislation (H.R. 22 (109th Cong., 1st Session)) *see* 2005 House Report; S. Rep. No. 108-318, 108th Cong., 2d Sess., at 16 (Aug. 25, 2004) (“2004 Senate Report”); and H.R. 22, 108th Cong. 1st Sess. (*see* H.R. Rep. No. 108-672(I), 108th Cong., 2d Sess., Part 1 (Sep. 8, 2004)(“2004 House Report”). These reports discuss similar or identical provisions to those eventually enacted as H.R. 6407. Pitney Bowes suggests these reports are generally instructive as to congressional intent.

Recommended Decision, it “has long promoted productive efficiency as a worthy goal of rate regulation . . . the promotion of postal sector productive efficiency, the reduction of the Postal Service’s end-to-end costs, and lower postal rates for mail users is a policy objective worth pursuing.”⁶ The Commission’s regulations with respect to pricing market dominant products should require the Postal Service to price products such that cost differences are reflected, to the maximum extent practicable, in rate differences. As discussed more fully below and in the comments of Dr. John C. Panzar,⁷ this may be achieved by observing the principles of ECP. The Commission’s regulations should provide that rates comporting with the principles underlying efficient component pricing principles are presumptively valid under the Act.

Enhance Mail’s Value Proposition. The PAEA, in its first stated statutory factor, directs that the Commission to take into account the value of mail to the sender and the recipient.⁸ The value of mail to *both* senders and recipients is essential to ensuring continued universal, affordable mail service. The Congress recognized this.⁹ Accordingly, the Commission’s regulations should encourage postal rates that promote appreciation of postal services. For example, this could be achieved through requirements and incentives that improve address

⁶ PRC Op. R2006-1, ¶ 4031 (quoting testimony of Dr. John C. Panzar (Docket No. R2006-1 Tr. 26/9171)).

⁷ See Initial Comments of John C. Panzar On Behalf Of Pitney Bowes Inc. In Response To Advance Notice Of Proposed Rulemaking On Regulations Establishing A System Of Ratemaking, PRC Docket No. RM2007-1, dated April 6, 2007 (“Panzar Comments”).

⁸ “[T]he Postal Regulatory Commission shall take into account (1) the value of the mail service actually provided each class of mail or type of mail service to both the sender and recipient . . .” 39 U.S.C. §3622()(2).

⁹ “In fact, developing an organizational culture of innovation and market responsiveness can help the Postal Service to address its financial difficulties by increasing the attractiveness of mail to both new and existing customers.” 2004 Senate Report, at 16. There are no committee reports accompanying H.R. 6407 (109th Cong., 2d Sess.), the bill that ultimately became the PAEA. There are committee reports accompanying earlier versions of postal reform legislation (H.R. 22 (109th Cong., 1st Session)) see H.R. Rep. No. 109-66, 109th Cong., 1st Sess., Part 1 (Apr. 28, 2005)(“2005 House Report”); S. 2468 (108th Cong. 1st Sess.)(see 2004 Senate Report); and H.R. 22, 108th Cong. 1st Sess. (see H.R. Rep. No. 108-672(I), 108th Cong., 2d Sess., Part 1 (Sep. 8, 2004)(“2004 House Report”). These reports discuss similar or identical provisions to those eventually enacted as H.R. 6407. Pitney Bowes suggests these reports are generally instructive as to congressional intent.

quality thereby reducing misaddressed, duplicative or otherwise unwanted mail. This mail has little or no value to the recipient.

The PAEA also requires the Commission to take into account “the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail.”¹⁰ 39 U.S.C. §3622(c)(1). *Intelligent mail* and sender-identified mail (“SIM”) bring a level of transparency to the mailstream via track and trace capability that will keep senders and recipients informed about their mail (including planning for date of delivery or receipt), help mailers manage their relationships, and make the mailstream safer. *Intelligent mail* and SIM also benefit the Postal Service by providing opportunities for reduced costs associated with workforce planning and service measurement and accountability.¹¹ The Commission’s regulations should promote, through requirements and incentives, *intelligent mail* and SIM. This will ensure a more secure, information-rich, and valuable mailstream.

Balance Pricing Flexibility with Predictability and Stability. An objective of the modern ratemaking system is “[to] allow the Postal Service pricing flexibility.” Similarly, a statutory factor directs the Commission to take into account the “importance of pricing flexibility to encourage increased mail volume and operational efficiency.” 39 U.S.C. §§3622(b)(4), 3622(c)(9). The PAEA affords increased pricing flexibility to the Postal Service through the elimination of the requirement for advance, on-the-record Commission review and approval of

¹⁰ For purposes of these comments the term “intelligent mail” is used as it is used in section 3622(c)(1) of the PAEA to mean any mail piece with enhanced information capabilities that increase the security and value of the mail piece to the sender or the recipient through the use of various barcode technologies or other unique information-rich identifiers. The term as used in the statute is intended to encompass existing technologies such as the Postal Service’s Intelligent Mail™ 4-State barcode technology and other current information based indicia (“IBI”) technologies, as well as potential future applications (e.g., a “secure stamp” for retail customers).

¹¹ The Postal Service has articulated its vision for intelligent mail and seamless acceptance as “provid[ing] end-to-end visibility and a seamless process for mail acceptance and delivery, using standardized intelligent barcodes, continuous mail tracking, and mail quality feedback in real time, to position Letters and Flats as a Key Communications Medium.” Postal Service presentation entitled *Intelligent Mail and Seamless Acceptance*, presented at the 2007 National Postal Forum, Washington, DC, at 2.

Postal Service rate adjustments. It also holds out the possibility of more frequent rate adjustments. The modern ratemaking system regulations should promote this flexibility. At the same time, the PAEA balances this flexibility with the statutory requirement that the modern ratemaking system “include an annual limitation on the percentage changes in rates.” 39 U.S.C. §3622(d)(1)(A). Within the constraints of this rate cap, the Commission’s regulations should accommodate the Postal Service’s new authority to make changes of unequal magnitude within, between, or among classes of mail, *see* 39 U.S.C. §3622(b)(8), the Postal Service’s freedom to implement seasonal, variable, or other dynamic pricing, *see* 39 U.S.C. §§3622(b)(4), 3622(c)(7), and the Postal Service’s expanded authority to enter into negotiated service agreements (“NSAs”), *see* 39 U.S.C. §3622(c)(10).¹²

In PRC Order No. 2 the Commission asked for comment on each of the statutory requirements, objectives, and factors, as well as the worksharing and competitive product provisions of the PAEA. They are discussed below.

A. STATUTORY REQUIREMENTS

1. Annual Limitation

The predictability and stability objective of the PAEA is largely achieved through the requirement of an annual limitation on the percentage changes in rates (including fees) in any given year, i.e., a rate cap.¹³ The annual limitation is equal to the percentage change in the Consumer Price Index for All Urban Consumers (“CPI”) unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its

¹² “Overall, the Committee believes that the rate cap structure established by the Postal Regulatory Commission should provide for the maximum possible pricing flexibility while maintaining adequate financial safeguards and incentives for cost control.” 2004 Senate Report, at 10.

¹³ “The system for regulating rates and classes for market-dominant products shall (A) include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index” 39 U.S.C. § 3622(d)(1)(A).

intention to increase rates. *See* 39 U.S.C. § 3622(d)(1)(A). The annual limitation must be applied on a class-by-class basis. Rate changes cannot exceed the annual limitation, but the PAEA is silent as to how permissible percentage changes in actual rates will be determined. The Commission's determinations in this regard will have a major effect on the Postal Service and mailers.

a. Rate Cap Mechanics

The Commission must determine the appropriate method for calculating the percentage changes in rates that are subject to the annual limitation. Under Section 3622(d), the average increase in rates for products within a class must be below the change in the CPI index for the relevant period. Pitney Bowes suggests calculating these changes on the basis of class revenue (calculated on a revenue per piece basis by rate category) weighted by rate category volume. The appropriate revenue per piece and volume is that for the same twelve month period used for purposes of computing the change in the CPI. In other words, the CPI change (annual limitation) is determined by looking back over the 12-months preceding the notice of intention to adjust rates required under section 3622(d)(1)(A). This may or may not be same notice as 45-day notice required for any actual rate adjustment under section 3622d)(1)(C).

The expected percentage changes the new rates would produce are calculated using the proposed new rates and the old rates both weighted by the volumes and mail mix from the period over which the CPI is calculated. This provides a relatively simple and predictable means for determining whether rate changes comply with the annual limitation, but still preserves pricing flexibility for the Postal Service.

This “backward-looking” frame of reference, often referred to as a Laspeyres index,¹⁴ has the advantage of relying on actual, verifiable data (not future volumes or estimates of future volume) regarding the volume and mail mix. It also enables the Commission to readily determine compliance with the statutory limitation shortly after the Postal Service files its notice of intention to increase rates under section 3622(d)(1)(A).

b. New Products / Special Classifications (NSAs)

The Commission’s regulations must also address a statutory uncertainty as to how the introduction of new products and negotiated service agreements will be taken into account for purposes of applying the annual limitation. To ensure that the annual limitation does not deter new product or pricing innovations, including NSAs, the Commission’s regulations should exclude *bona fide* new products and special classifications from its determination of compliance with the annual limitation until the year after which they are introduced.¹⁵ This treatment is consistent with the statutory rule for products introduced through market tests. *See* 39 U.S.C. § 3641(a)(2).

c. “Banking” Authority

The PAEA defines “unused rate adjustment authority” and permits the Postal Service to “bank” it for up to five years for future use under specified conditions. *See* 39 U.S.C.

¹⁴ A Laspeyres index weights prices by the volumes from the year over which the CPI is measured. An obvious alternative to a Laspeyres index is a Paasche index. A Paasche index weights prices by the volumes for the year the rates will be effect. Under a Paasche index, compliance with the cap could not be assured until after the year for which the rates were in effect and it would be very difficult for the Service to design a set of rates which would be both compliant and still use most of the CPI cap authority. *See* “The Difference Between the Paasche and Laspeyres Index-Number Formulas” by Irving H. Siegal, *Journal of the American Statistical Association*, Vol. 36, No. 215.(Sept., 1941), pp. 343-50; *see also* “Pricing, Entry, Service Quality, and Innovation under a Commercialized Postal Service” by Michael A. Crew and Paul R. Kleindorfer, p.162 in *Governing the Postal Service*, edited by J. Gregory Sidak, AEI Studies in Postal Regulation, AEI Press, 1994.

¹⁵ This treatment is consistent with the experiences of other regulated network industries (notably telecommunications) and other postal price cap regimes. *See* Michael A. Crew and Paul R. Kleindorfer, “Pricing, Entry, Service Quality, and Innovation under a Commercialized Postal Service,” in *Governing the Postal Service*, edited by Gregory J. Sidak, Washington: AEI Press, 1994, p. 166 (discussing exclusion of new products from price cap regime as a means to stimulate innovation and the development of new services).

§3622(d)(2)(C). The Commission’s regulations should clarify how the amount of “unused rate adjustment authority” is determined and how it may be used.

The statute is unclear whether the amount should be determined on a percentage or an absolute dollar basis. The most straight-forward approach is to allow the Postal Service to “bank” a percentage of cap authority rather than an absolute dollar amount.

The Commission’s regulations should also address whether “unused rate adjustment authority” is transferable among classes. Pitney Bowes suggests it should not be, but rather should be “earmarked” for the same class in which it was previously “unused.” This result is supported by both policy and practical considerations. It is consistent with the statutory requirement to apply the rate cap at the class level. *See* 39 U.S.C. § 3622(d)(2)(C). The PAEA is explicit that “the annual limitations . . . shall apply to a class of mail.” 39 U.S.C. § 3622(d)(2)(A). Permitting inter-class shifting of unused rate authority could distort the effect of the annual limitation among classes that would offend general notions of fairness.

d. Prohibit Uncompensated Cost Shifting

The Commission regulations must also ensure that the Postal Service cannot circumvent the annual limitation through uncompensated service degradation (such as delivery service cutbacks) or the imposition of preparation or other mailing requirements. Such uncompensated cost shifting is the effective equivalent of increasing rates. It is analogous to imposing an “unfunded mandate” that would frustrate the purpose of the annual limitation.¹⁶

¹⁶ *See* Michael A. Crew and Paul R. Kleindorfer, “Pricing, Entry, Service Quality, and Innovation under a Commercialized Postal Service,” in *Governing the Postal Service*, edited by Gregory J. Sidak, Washington: AEI Press, 1994, p. 166 (“Under a price-cap regulation, the issue of service quality would take on increasing importance as the Postal Service seeks to further ways of reducing costs as a result of the incentives created by the price cap.”).

2. Exigency

The approach to the price cap differed between the two Houses, but eventually the Congress settled on a “hard cap” as an efficiency enhancing discipline on the Postal Service.¹⁷ However, in Section 3622(d)(1)(E), Congress also required the Commission to establish procedures to allow rate adjustments in excess of the annual limitation on an expedited basis due to either “extraordinary or exceptional” circumstances. This has been referred to as the “exigency clause.”

The PAEA does not define the terms “extraordinary” or “exceptional” but the legislative history suggests that exigent increases should be rare.¹⁸ The exigency clause is designed to address circumstances that are by definition unanticipated system disruptions (e.g., the events of September 11, 2001), for which the Postal Service cannot adopt prudent risk mitigation strategies. Because these deal with unforeseen circumstances, the Commission should address what constitutes an “extraordinary” or “exceptional” circumstance on a case-by-case basis as circumstances arise.

Importantly, even if “extraordinary or exceptional” circumstances exist, there are additional requirements which must be satisfied before the Postal Service may increase rates in excess of the annual limitation. First, section 3622(d)(1)(E) provides that the Postal Service draw upon any “unused rate adjustment authority” under section 3622(d)(2)(C) before exceeding

¹⁷ See e.g., S. 662, as introduced, 109th Cong., 1st Sess., § 201(a) adding 39 U.S.C. § 3622(d)(1)(D) (annual limitation may be exceeded only under “unexpected and extraordinary circumstances”); H.R. 22, as reported, 109th Cong., 1st Sess., § 201(a) adding 39 U.S.C. § 3622(e) (average rate increase may exceed increase in the Consumer Price Increase if the Postal Regulatory Commission determines “such increase is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.”).

¹⁸ “[T]he terrorist attacks of September 11, 2001 and the subsequent use of the mail to transmit anthrax highlight the need to address unexpected and extraordinary circumstances and their effect on the Postal Service and its financial requirements. Therefore, the Postal Regulatory Commission shall establish procedures under which the Postal Service can adjust rates on an expedited basis due to unexpected and extraordinary circumstances. The Committee hopes that these procedures will never be needed” 2004 Senate Report, at 11.

the cap. Second, the Commission may allow an increase in excess of the annual limitation only if it determines that increase “is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” 39 U.S.C. §3622(d)(1)(E). This is a time-tested standard with which the Commission has substantial experience.¹⁹

3. Schedule / Procedures

Section 3622(d) provides that the Commission shall establish a schedule and procedures whereby the Postal Service may adjust rates, when necessary and appropriate, subject to the annual limitation. Section 3622(d) outlines eight key elements in the rate adjustment process for market-dominant products:

- (1) A schedule for rate changes at “regular intervals by predictable amounts” which is established by the Commission;
- (2) A “notice of intention to increase rates” by the Postal Service, that triggers the twelve-month time period for determining the “annual limitation;”
- (3) A “public notice of the adjustment” which is required not later than 45 days before the implementation of any adjustment in rates by the Postal Service;
- (4) A “quick look” by the Commission under section 3622(d)(1)(C) to assess compliance with the annual limitation;
- (5) An opportunity for the Postal Service to “cure” any deficiency, identified by the Commission;
- (6) An annual determination of Postal Service compliance by the Commission under section 3653 following the Postal Service’s submission of its annual report to the Commission;
- (7) Opportunities for rate and service complaints brought by interested parties under section 3662; and
- (8) Opportunities for appellate review of Commission decisions under section 3663.

a. Schedule and Procedures: Mechanics

Generally speaking, the Commission should not prescribe overly rigid rules regarding the schedule or procedures for rate adjustments. Rather, the Commission’s regulations should

¹⁹ See former 39 U.S.C. § 3621.

establish broad contours that afford the Postal Service maximum flexibility. The legislative history is clear that pricing flexibility is an important objective of the modern ratemaking system.²⁰

With respect to the timing of rate adjustments, section 3622(d)(1)(C) provides that “not later than 45 days before implementation of any adjustment” the Postal Service must provide public notice of the proposed rate adjustment. Forty-five days is the minimum notice period, not a maximum. The Postal Service is best-positioned to determine whether additional advance notice is necessary for successful implementation of its rate changes. Indeed, the Postal Service may opt for additional advance notice to allow for the development of software and systems necessary to implement more complex rate changes.

b. Procedural Pricing Flexibility As a Key Objective of PAEA

The PAEA provides the Postal Service with a substantial degree of procedural pricing flexibility. This is particularly true with respect to the authority to propose and implement new rates without an advance, on-the-record hearing. The PAEA makes clear Congress intended procedural pricing flexibility that would result in a significant reduction in the administrative burden of the rate setting process. *See* 39 U.S.C. §3622(b)(6). Increased procedural pricing flexibility will also enable the Postal Service to use the rate setting process to grow mail and respond to changing operational or market conditions through seasonal, variable, or other dynamic pricing.

i. *Dynamic Pricing*

The Commission’s regulations addressing the schedule and procedures for rate adjustments should promote flexible pricing techniques, including seasonal, variable, or other

²⁰ “[A] rigid, and overly litigious rate-setting process limits the Postal Service’s ability to adjust rates as needed and to adapt postal prices and products to a changing marketplace.” 2004 Senate Report, at 8.

dynamic pricing. For example, the Postal Service should be afforded the flexibility to provide dynamic pricing for market dominant products within a published range of prices. Through dynamic pricing the Postal Service can manage mail flows (e.g., incent mailers to enter mail at specific locations or times), address seasonal demands and respond to unanticipated changes in economic events (e.g., spikes in paper costs, fluctuations in advertising spending, economic slowdowns). This pricing flexibility will allow Postal Service to vary rates to meet changing market dynamics, increase demand for mail and improve operational efficiency.

The regulations should permit adjustments more frequently than annually, provided the possibility of such an adjustment is noted in the schedule required by section 3622(d)(1)(B), and some Commission prescribed additional minimum notice is provided prior to the seasonal, variable, or other dynamic adjustment. To ensure compliance with the annual limitation, these adjustments, at least initially, should be limited to rate reductions.

ii. *Avoiding Rate Setting Rigidity*

Pricing flexibility can and must be balanced with another objective of the PAEA – rate predictability and stability. Clearly, the regularly scheduled notice of intention to adjust rates coupled with adherence to the annual limitation required under section 3622(d)(1)(A) and (B) will ensure predictability and stability. Predictability and stability, however, does not require rate setting rigidity. Different segments of the mailing public may be better able to respond to and may even welcome more complex and flexible rates. In this respect, the needs of business mailers and consumer mailers may differ. The introduction of the Forever Stamp certainly affords a new degree of predictability and stability for consumer mailers.

iii. *“Quick Look” Compliance Review upon Public Notice of the Adjustment*

Section 3622(d)(1)(C) requires the Commission to conduct a “quick look” review of any rate adjustment proposed by the Postal Service. This further ensures predictability, but should not be administered in a manner that deters pricing flexibility.

The PAEA is clear that this “quick look” review is limited to a determination of whether the noticed rate adjustment complies with the annual limitation under section 3622(d)(1)(A). The limited nature of this review is reinforced by the fact that the Act provides as few as 45 days for the Commission to review the proposed adjustment and the Postal Service to “cure” any Commission identified defect if necessary.

Thus, the 45-day “quick look” is a rate cap compliance matter. Other compliance determinations such as those required for workshare discounts under section 3622(e) should be addressed through the annual determination of compliance under section 3653, not the “quick look” process.

iv. *Transparency of the Rate-setting Process*

(1) The “Notice of Intention to Increase Rates”

Enhanced pricing flexibility must be balanced with the need for transparency and with due process considerations. Accordingly, the Commission’s regulations should require that the Postal Service’s notice of intention to increase rates under section 3622(d)(1)(A) include sufficient information to allow interested parties a meaningful opportunity to assess the underlying cost basis for and relationships between rates and to determine compliance with the Act’s objectives and factors.

The Commission’s existing rules should serve as the benchmark for the level of information and data necessary and appropriate to inform the Commission and the mailing public of the nature, scope, and significance of rate adjustments. *See* 39 C.F.R. § 3001.54. If the notice

of intention to increase rates is relatively contemporaneous with the filing of the annual report to the Commission under section 3652, the notice could incorporate information in that report by reference. This would reduce administrative burden on the Postal Service, facilitate transparency, and safeguard the due process rights of interested parties.

(2) Enabling An Effective Complaint Process

The Commission's annual compliance determination under section 3653 is an "after the fact" year-end review. Thus, there is the potential for a significant passage of time between the Postal Service's implementation of a rate adjustment and a substantive review by the Commission of data and information underlying that adjustment.²¹ Requiring the Postal Service to provide cost data and information with its notice of intention to increase rates under section 3622(d)(1)(A) will allow interested parties an opportunity to review and challenge rates at the time the rates are implemented.

The complaint process prescribed under section 3662 is more robust than that under previous law. This strengthened complaint process becomes, under the PAEA, the primary avenue of protection for mailers.²² The value of this statutory protection is diminished, however, if interested parties are not afforded a timely and meaningful opportunity for review. Specifically, unless there is sufficient data and information available in connection with a notice of intention to increase rates, the ability of interested parties to pursue timely redress through the complaint process may be substantially compromised.

Under section 3652 the Postal Service must submit its annual report to the Commission within 90 days of end of the fiscal year. The Commission then has 90 days to review the annual

²¹ As discussed above, the 45-day "quick look" review is limited to determining compliance with the annual limitation.

²² The complaint process will be the subject of a subsequent rulemaking. *See* n.4 *supra*.

report, consider public comment, and issue its compliance determination under section 3653. If the Postal Service does not include cost data and information contemporaneous with the notice of intention to increase rates, interested parties may have no basis on which to challenge an unlawful rate until the subsequent filing of the annual report (assuming sufficient public access to cost data in that context). As a result, the first meaningful opportunity for interested parties to file a complaint under section 3662 could many occur months after a rate increase and during the same time that the Commission is required to conduct its compliance review. Thus, the 90-day period during which Commission must decide whether to take up a complaint may overlap with 90-day annual compliance review period, a particularly busy time for the Commission. *See* 39 U.S.C. § 3662(b)(1).

Effectively limiting the opportunity to complain until the time of the annual compliance review also erects unwarranted procedural hurdles for complainants. Section 3653 provides a rebuttable presumption in support of Commission findings in connection with the annual compliance determination. Thus, where a complaint follows the Commission's annual compliance determination, the burden of proof on the complainant is increased.

Therefore, to appropriately balance the transparency of the rate-setting process with the Postal Service's interest in flexibility, the Commission's regulations should require the Postal Service to provide, at the time of its notice of intention to increase rates, sufficient contemporaneous data and information to justify the prospective rate adjustments.

v. *Negotiated Service Agreements*

The PAEA specifically recognizes the “desirability of special classifications . . . including agreements between the Postal Service and postal users . . .” 39 U.S.C. § 3622(c)(10). These today are termed “negotiated service agreements.” *See* 39 C.F.R. §§ 3001.190 *et seq.* The Commission may initiate a subsequent rulemaking to revise its existing

rules in this area. There is, however, an initial matter of concern pertaining to the noticing of rate adjustments.

Pitney Bowes suggests the Commission's regulations specific to NSAs must take care to recognize the confidentiality issues and commercial sensitivity concerns that are unique to NSAs. A starting point for these regulations is the Commission's existing rules regarding *in camera* orders. *See* 39 C.F.R. § 3001.31a. In addition, the Commission's implementing regulations should conform NSA confidentiality protections to those protections set forth under section 504(g) relating to information obtained under subpoena. The same disclosure protections are also afforded to market tests for experimental products under section 3641(c)(2).

B. OBJECTIVES AND FACTORS

In many respects the PAEA may be viewed as the legislative modernization of the Postal Reorganization Act of 1970 ("PRA"), *see* Pub. L. No. 91-375, 84 Stat. 719, rather than an entirely new legislative initiative. Nowhere is this more evident than in the PAEA's restatement, and in some cases modification, of many of the PRA's rate setting factors. The restatement of the PRA's statutory ratemaking provisions evidences Congress intent for a continuing, active Commission role with respect to how rates are set for market dominant products.

1. Statutory Objectives of the Modern Ratemaking System

a. Reduce Costs and Increase Efficiency

Section 3622(b)(1) provides that the Commission shall design a modern ratemaking system for market dominant products to "maximize incentives to reduce costs and increase efficiency." Under the PAEA Congress maintains the Postal Service's monopoly and reserves to Congress the authority to alter that monopoly in the future. At the same time, the PAEA prescribes a regulatory framework that contemplates an active regulator working to ensure that rates promote increased efficiency to reduce the costs of providing postal services to the mailing

public.²³ Efficiency considerations are appropriately stated as the first objective of the PAEA.²⁴

The modern ratemaking system should be designed to maximize productive efficiency and minimize total costs for the postal sector. This will grow the mail, enhance the value of the mailstream, and ensure universal, affordable, mail service.

The Commission's regulations establishing the modern ratemaking system should require rate design and pricing incentives that ensure that rate differences, to the maximum extent practicable, fully reflect Postal Services cost differences. In other words, the Commission's regulations should require the Postal Service to apply and extend the principles underlying Efficient Component Pricing ("ECP").²⁵

Such a cost-based rate regime would serve several purposes. First, a cost-based rate system that accurately and fully reflects cost differences in rate differences will enhance productive efficiency and minimize the total costs for the postal sector. As the Commission noted in its most recent Opinion and Recommended Decision there are many cost-causative characteristics of a mail piece over which a mailer can exercise some control:

Witness Panzar has provided the insight that if cost differences equal rate differences then mailers can make informed choices which minimize net end-to-end mailing costs. Moreover, it seems to be fundamentally fair that mailers pay the costs they impose upon the Postal Service plus the same contribution per piece that all the mailers make within the same subclass. This is the definition of an ECP price. For all these reasons, and contrary to what the Commission articulated in R2000-1 about the neutral starting position for rate design, the Commission now believes, and with good evidence, that the

²³ In this important respect, the regulatory regime for the U.S. postal sector will be unique as compared to other regulated network industries (e.g., telecommunications, energy) because the regulated entity operating under the price cap is a public monopoly, not a private profit maximizing firm with readily identifiable residual claimants (shareholders).

²⁴ "S. 2468 requires the new Postal Regulatory Commission to develop -- with appropriate input from the postal community -- a new, highly streamlined, rate-setting process. This new process should apply rigorous standards to rate-setting, but at the same time, give postal officials the ability to manage and lead. The process should also proactively encourage the Postal Service to improve productivity and efficiency and not rely solely on rate increases to secure its fiscal health." 2004 Senate Report, at 32-33.

²⁵ See Panzar Comments at 5.

neutral starting position should equal the per-piece contribution because this promotes productive efficiency.

PRC Op. R2006-1, ¶ 4032.

If the Commission continues to encourage a ratemaking system in which cost differences equal rate differences, mailers and consumers will make informed and efficient choices that minimize the end-to-end system costs. Importantly, the principles underlying ECP can and should be extended by the Commission regulations to apply to all cost-causative characteristics of mail including shape, weight, distance, payment evidencing, address hygiene and others.

A cost-based ratemaking system will also maximize productive efficiency with respect to traditional workshare discounts. In simplest terms, worksharing discounts induce mailers to perform cost saving activities for the Postal Service. To receive these discounts, mailers perform some of the work involved in an unbundled component of the Postal Service's end-to-end service. When this occurs, ECP dictates that the discounts mailers receive for performing this work should *equal* the per unit avoided cost of the Postal Service. When discounts are set *equal* to costs avoided, a mailer is induced to perform work if and only if that mailer can perform the work less expensively than the Postal Service. Thus, productive efficiency results from a classic "make or buy" decision for the mailer and the Postal Service. Mailers will choose to engage in worksharing if doing so will lower their costs, thereby also lowering total postal sector costs.²⁶

Finally, in view of the continuation of the Postal Service's statutory monopoly, a cost-based system is necessary to ensure continued and expanded upstream access to services and products where private parties can provide value and efficient solutions, and to protect against

²⁶ See Panzar Comments at 7-8.

the risk of predatory pricing of bundled services that result in a “vertical price squeeze” or “margin squeeze.”²⁷

b. Predictability and Stability

Section 3622(b)(2) provides that the Commission shall design a modern ratemaking system for market dominant products to “create predictability and stability.” Predictability and stability for mailers and the mailing public is achieved through an annual limitation on rate increases tied to increases in the CPI. The annual limitation, the most prominent new feature of the PAEA, is the primary tool available to the Commission to ensure predictable and stable rates. Predictability and stability are further assured through the tight “exigency clause” that requires the USPS to manage costs and seek improved efficiencies to comply with the annual limitation.

The predictability and stability promised to mailers is the counterweight to the expanded pricing flexibility afforded the Postal Service under streamlined ratemaking procedures, including the elimination of the requirement of an advance, on-the-record rate case.

c. Service Standards

Section 3622(b)(3) provides that the Commission shall design a modern ratemaking system for market dominant products to “maintain high quality service standards.” Meaningful service standards are an important means of enhancing the value of mail. Although the establishment of service standards will be the focus of a separate process pursuant to section 3691, the importance of service standards is reflected in the statutory objectives of the PAEA.

Visibility into the mailstream (e.g., tracking and tracing), which will result from the promotion of *intelligent mail* required by section 3622(c)(13), will further the achievement,

²⁷ See David Sappington, “Regulation, Competition, and Liberalization” *Journal of Economic Literature*, Vol. XLIV, June 2006, at pp. 353-354 (discussing potential for anti-competitive price squeeze by a vertically integrated producer and noting “particular importan[ce] to monitor and implement procedures to preclude below-cost pricing by a firm that operates under price cap regulation”); *see also* Panzar Comments at 13-14 (discussing why worksharing discounts which are less than costs avoided are inefficient, exclusionary and anticompetitive).

measurement, and maintenance of high quality service. *Intelligent mail* is a particularly effective tool for gathering service-related information. Accordingly, the Commission’s regulations should encourage the Postal Service to leverage private sector resources and technology through pricing incentives and partnership opportunities to promote *intelligent mail* as a means to improve service.

d. Pricing Flexibility

Section 3622(b)(4) provides that the Commission shall design a modern ratemaking system for market dominant products to “allow the Postal Service pricing flexibility.” In addition, section 3622(b)(8) gives the Postal Service the authority to make changes in rates of “unequal magnitude within, between, or among classes of mail.”

The PAEA promotes pricing flexibility in several important respects. It eliminates today’s prolonged, expensive, complex, and adversarial on-the-record rate setting process thereby reducing administrative burden. This permits the Postal Service to adjust rates in response to market conditions. Thus, the Commission’s regulations should facilitate seasonal, variable, or other dynamic pricing, so the Postal Service can tailor rates to meet market dynamics and customer needs, increase demand, and improve operational efficiency.

e. Retained Earnings / Financial Stability

Section 3622(b)(5) provides that the Commission shall design a modern ratemaking system for market dominant products to “assure adequate revenues, including retained earnings, to maintain financial stability.” The retained earnings provision satisfies three policy objectives.

First, retained earnings promote the financial security of the Postal Service. They should help tide the Postal Service over in times of financial difficulty.

Second, retained earnings help ensure the long term viability of the postal system. The ability to retain earnings is essential to allow the Postal Service to accumulate what it needs to invest to modernize, grow the business, and improve the postal system.

Third, retained earnings can help reward and retain Postal Service officers and employees. The Postal Service may use a portion of its retained earnings to incent performance through officer and employee bonuses authorized under section 3686, thereby investing in its human capital and rewarding its employees for exemplary performance.

f. Reduced Administrative Burden / Transparency

Section 3622(b)(6) provides that the Commission shall design a modern ratemaking system for market dominant products to “reduce the administrative burden and increase the transparency of the ratemaking process.”

As discussed more fully above, the Commission’s regulations governing the schedule and procedures for proposed rate adjustments can facilitate the achievement of this statutory objective. Specifically, the Commission’s regulations should recognize and promote increased procedural pricing flexibility while ensuring that interested parties are provided a meaningful opportunity to review and challenge rates or classifications that they believe are inconsistent with the statutory requirements.

g. Mail Security

Section 3622(b)(7) provides that the Commission shall design a modern ratemaking system for market dominant products to “enhance mail security and deter terrorism.” An information-rich, secure mail stream will enhance mail security, deter terrorism and protect the critical infrastructure of the mailstream.

Bioterrorism attacks on the postal system in 2001 highlighted the security risk of anonymous mail. Broadly construed “secure” mail is any mail piece that uniquely identifies the

sender and the mail piece by means of a unique barcode, information based indicia (“IBI”), secure retail postage stamp or other indicia. The Commission’s regulations should encourage the Postal Service to promote sender-identified mail (“SIM”). Specifically, its regulations should encourage the Postal Service to use pricing incentives to drive mail users to produce secure mail and encourage the Postal Service to promote technology that enables SIM. The Commission’s regulations should ensure that retail consumers can take full advantage of pricing incentives via on-line and self-service (e.g., ATMs, meters, kiosks) retail access channels. This will not just reduce security-related risks, but also will reduce postal system costs by deterring attacks or mischief through the mail which disrupt postal operations or compromise critical infrastructure.

Mail security also entails revenue protection, particularly secure postage payment evidencing. The Commission should encourage the Postal Service to promote the use of technology that deters revenue fraud. Revenue losses resulting from insecure payment evidencing impose costs on the postal system. These costs can and should be quantified and pricing incentives which reflect the cost differences attributable to differing security attributes of payment evidencing systems should be encouraged. This will incent mailers to use the most secure payment evidencing technologies.

h. Just and Reasonable / Unequal Rate Changes

Section 3622(b)(8) provides that the Commission shall design a modern ratemaking system for market dominant products to “establish and maintain a just and reasonable schedule of rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.” The Commission’s regulations should make clear the Postal Service is empowered to price products such that cost differences are fully reflected in rate differences even

if that means that rates within, between and among classes do not increase in lock-step or maintain historical relationships.

i. Allocation of Institutional Costs

Section 3622(b)(9) provides that the Commission shall design a modern ratemaking system for market dominant products that appropriately allocates institutional costs between market dominant and competitive products. This statutory objective is discussed below in part III relating to competitive products.

2. Statutory Factors of the Modern Ratemaking System

The PAEA provides that 14 statutory “factors shall be taken into account.” With some notable exceptions, these factors largely “encompass the current pricing and classification criteria.”²⁸ The discussion below of the historical interpretation of these factors reflects that in testimony of Postal Service rate design witnesses in past omnibus postal rate cases.²⁹

a. Value of Service

Section 3622(c)(1) requires the Commission to take into account the “value of service of the mail actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery.”

This statutory factor recodifies without change a previous PRA provision.³⁰

This factor has historically been understood to refer to the intrinsic value of the service provided to a class of mail, typically assessed by the degree to which usage of the service

²⁸ “In designing the regulatory structure, the Postal Regulatory Commission shall take into account twelve factors. These factors encompass the current pricing and classification criteria [39 U.S.C. §§ 3622(b) and 3623(c)] used by the Postal Rate Commission to evaluate the Postal Service’s Governors’ rate and classification requests. The Committee believes that these factors have served a useful role in evaluating rate and classification changes under the current regulatory structure and will provide similar policy guidance for the development of the new regulatory system.” 2004 Senate Report, at 9.

²⁹ See PRC Docket No. R2006-1, USPS-T-31 (O’Hara); PRC Docket No. R2000-1, USPS-T-32 (Mayes).

³⁰ See former 39 U.S.C. § 3622(b)(2).

declines in response to price increases, often referred to as the economic value of service, measured by the own-price elasticity of demand for the particular service.

The Commission has substantial experience in evaluating this ratemaking criterion. Its recodification suggests that the Congress, mindful of the Commission's prior precedents, did not intend a change in direction under the PAEA.

One other dimension of the "value of service" ratemaking criterion that was not fully developed under prior Commission precedents is the concept of "no cost value pricing."³¹ The Commission regulations should discourage value pricing of products or product enhancements that do not impose a cost on the Postal Service. Such pricing is tantamount to a tax on innovation that will frustrate efforts under the PAEA to reduce costs and improve efficiency. "No cost value pricing," which in effect penalizes customers for adding value to mail, is also antithetical to the PAEA's broader policy objectives of enhancing the value of the mail as a vital communications medium and promoting a vibrant, growing mailing industry.

b. Cost Coverage Requirement

Section 3622(c)(2) provides that the Commission shall take into account "the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that

³¹ For example in PRC Docket No. MC2004-5 the Postal Service filed a request for a new classification and rate for the attachment of Repositionable Notes ("RPNs") on the covers of First-Class Mail, Standard Mail, and Periodicals. In that proceeding the Postal Service conceded that the attachment of the RPN on the mailpiece did not impose any costs on the Postal Service. The Commission first approved the change on a provisional basis in December 2005 and the Postal Service has subsequently filed for multiple extensions of the provisional classification, including a request filed earlier this week .Docket No. MC2007-2, Request of the United States Postal Service for a Recommended Decision on Change of Expiration Date for Provisional Repositionable Notes Classifications and Rates (April 2, 2007). As discussed in its December 2005 Opinion and Recommended Decision the Commission's recommendation of the provisional rate was qualified by the procedural context of its decision. The provisional service change was to be limited duration and the Commission specifically noted that the evidence presented by the Postal Service would not have been sufficient to support a proposal for a permanent change in classification or rates. Pitney Bowes suggests the Commission should impose a heavy burden on any Postal Service request to engage in "value pricing" for products or product enhancements that do not impose a cost on the Postal Service.

portion of all other costs of the Postal Service reasonably assignable to such class or type.” 39 U.S.C. § 3622(c)(2).

This restates, with some modification, a PRA ratemaking factor, commonly referred to as “factor 3,” that was the subject of much litigation.³² The restatement of this former PRA provision supports continued emphasis on cost-based rates. Generally, that former ratemaking criterion was interpreted to require that the revenues from each class of mail at least equal the costs “attributable” to that class.³³ “Attributable costs” were calculated on the basis of “incremental costs” at the subclass level. The PAEA adds the requirement that cost be attributed “through reliably identified causal relationships.” This reflects past Commission ratemaking practice.³⁴

c. Rate Shock

Section 3622(c)(3) requires the Commission to take into account the “effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters.”

This statutory factor recodifies without change a previous PRA provision.³⁵

³² The United States Supreme Court has observed that “[t]he Commission’s ratemaking process is well-established, in large part, because in each rate case the Commission has explained its pricing decisions, taking care to distinguish circumstances that may have a particular bearing on the recommended rates. The pricing factors are quite broad, but only one, factor 3, is a requirement.” *National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810, 820 (1983).

³³ In its most recent decision the Commission described the process as follows, “[r]ecommended rates are developed in a two-step process. First, recommended rates for each class or type of mail must be adequate to recover “the direct and indirect postal costs attributable to that class or type [of mail].” The Commission satisfies this requirement by recommending rates that recover attributable costs. Thus, attributable costs form the floor for the Commission’s recommended rate levels.” PRC Op. R2006-1, ¶¶ 4042-43.

³⁴ “The NAGCP Court [*National Association of Greeting Card Publishers v. United States Postal Service*, 462 U.S. 810 (1983)] rejected a contention that it was appropriate to make classes responsible for the recovery of costs for which an extended inference of causation was claimed. It emphasized the need for reliable indicators of causality without specifying any specific method for identifying causality. Governed by this ruling since 1982, the Postal Rate Commission must have reasonable assurance that any costs attributed to a class of mail are incurred as a result of providing that class of mail. The Committee finds no reason for changing this standard.” 2004 Senate Report, at 10.

³⁵ See former 39 U.S.C. § 3622(b)(4).

Historically, this ratemaking criterion required consideration of the effect of rate increases on both customers and private-sector competitors of the Postal Service taking into account percentage rate increases relative to the overall rate of inflation and inter-class relationships. Predictable and stable rates that satisfy the annual limitation required under section 3622(d) will appropriately address this factor.

d. Available Alternatives

Section 3622(c)(4) requires the Commission to take into account the “available alternative means of sending and receiving letters and other mail matter at reasonable costs.”

This statutory factor recodifies without change a previous PRA provision.³⁶

Historically, the application of this ratemaking criterion involved the consideration of cross-price elasticities and the availability of similar services from other providers, often private-sector competition in the expedited and package delivery markets and alternate delivery firms for periodicals. In applying it the Commission also considered the availability of other media, such as newspapers, radio, and television, for the delivery of advertising messages and various electronic alternatives for First-Class Mail. Email, electronic funds transfer, and text messaging have recently emerged as alternatives which should be “taken into account” under this factor. Alternatives to mail often do exist and should be taken into account in pricing market dominant products to ensure a viable postal system that supports universal, affordable postal service.

e. Degree of Preparation

Section 3622(c)(5) requires the Commission to take into account the “degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service.”

³⁶ See former 39 U.S.C. § 3622(b)(5).

This statutory factor recodifies without change a previous PRA provision.³⁷

Historically, this ratemaking criterion was applied with respect to the effect of workshare activities on Postal Service costs. The relative importance of this factor grew as worksharing matured. The Postal Service and the Commission have a well-established track record of success in encouraging workshare discounts to promote mailer activities and upstream access as a means to improve overall system efficiency and reduce total postal sector costs.³⁸ This supports the goal of ensuring the continuation of universal, affordable mail service. The modern ratemaking system should leverage this experience and continue to facilitate the Postal Service's role as one of the most collaborative posts in the world. The PAEA encourages the increased use of partners to add value, reduce costs and increase operating efficiency through expanded workshare and outsourcing opportunities. The modern ratemaking system should promote the continued expansion of workshare opportunities to increase postal productivity and efficiency. As discussed above and in the initial comments of Dr. Panzar, the Commission's regulations should promote expanded opportunities for worksharing and the expanded application of the principles underlying ECP beyond traditional worksharing. This will result in rates that fully reflect the intrinsic cost-causative characteristics of the mailpiece, including shape, weight, distance, payment evidencing, and address hygiene. Similarly, the modern ratemaking system under the PAEA should continue worksharing as a means to promote competitive access to those upstream activities for which the Postal Service does not have a statutory monopoly, but does have a market dominant position.

³⁷ See former 39 U.S.C. § 3622(b)(6).

³⁸ See R. Cohen, M. Robinson, J. Waller, and S. Xenakis, "Worksharing: How Much Productive Efficiency, at What Cost and at What Price?" in *Progress Toward Liberalization of the Postal and Delivery Sector* (Springer), edited by M. Crew and P. Kleindorfer (2006); E. Pearsall "The Effects of Worksharing and Other Product Innovations on U.S. Postal Volumes and Revenues in *Regulatory and Economic Challenges in the Postal and Delivery Sector* (Kluwer), edited by M. Crew and P. Kleindorfer (2005).

Also as discussed above, the Commission’s regulations should deter the imposition of *uncompensated* preparation, entry, or other requirements. Such unfunded mandates would result in effective rate increases that could frustrate the section 3622(d) requirement of an annual limitation on rate adjustments.

f. Simplicity of Rate Design

Section 3622(c)(6) requires the Commission to take into account the “simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services.”

This statutory factor recodifies without change a previous PRA provision.³⁹

The Commission has historically recognized simplicity primarily as an issue for retail, Single-Piece mailers. However, the recent advent of the Forever Stamp and emerging technologies such as automated retail sales alternatives (e.g., meters, on-line postage, kiosks, and ATMs) which are increasingly available to small volume and retail mailers will continue to diminish the importance of this statutory factor.

Accordingly, this factor should not be applied to limit or constrain the pricing flexibility of the Postal Service or the overall efficiency goals of the PAEA. Large commercial mailers are comfortable with, and often desire, complex rate design that recognizes costs. The universe of “sophisticated” mailers is expanding rapidly with the advent and increasing availability of alternative intelligent payment evidencing channels and the extended reach of presort services to smaller business markets. Thus, new technologies that simplify postage payment for small volume and consumer mailers should enable the Postal Service to offer greater pricing flexibility to all mailers.

³⁹ See former 39 U.S.C. § 3622(b)(7).

g. Pricing Flexibility

Section 3622(c)(7) requires the Commission to take into account the “importance of pricing flexibility to encourage increased mail volume and operational efficiency.”

This is a new ratemaking factor under the PAEA.

As discussed above, increased pricing flexibility for the Postal Service is one of the fundamental objectives of the PAEA. Procedurally, the Postal Service is afforded enhanced pricing flexibility through the elimination of required advance, on-the-record Commission review of rate adjustments. Pricing flexibility is also enhanced through the opportunity for more frequent rate adjustments, the ability to make changes of unequal magnitude within, between, or among classes of mail, and the freedom to implement seasonal, variable, or other dynamic pricing. Finally, the PAEA specifically recognizes and promotes NSAs as a manifestation of the Postal Service’s pricing flexibility.

The modern ratemaking system should encourage the Postal Service to employ rate incentives to leverage pricing flexibility. This will grow mail volumes, reduce costs, and improve operational efficiency.

h. Relative Value / Special Classifications

Section 3622(c)(8) requires the Commission to take into account the “relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail.” This is a new ratemaking factor under the PAEA. Under the PRA it was a factor to be considered with respect to mail classification.⁴⁰ It supports promotion of private sector innovation to enhance the efficiency and value of the mailstream.

⁴⁰ See former 39 U.S.C. § 3623(c)(2).

As discussed above, the Commission regulations should discourage “value pricing” of products or product enhancements which do not impose a cost on the postal system. Such pricing is tantamount to a tax on innovation that will frustrate efforts under the PAEA to reduce costs, improve efficiency and enhance the value of mail as a means of better serving the needs of the mailing public.

i. Reliability / Speed of Delivery Alternatives

Section 3622(c)(9) requires the Commission to take into account the importance of providing classifications with differing degrees of “reliability and speed of delivery.” This is a new ratemaking factor under the PAEA. It combines two former PRA factors that applied to mail classification.⁴¹ The Commission’s regulations should encourage the Postal Service to explore and promote new service offerings, including “date certain” delivery products.

j. Special Classifications (NSAs)

Section 3622(c)(10) requires the Commission to take into account the “desirability of special classifications for both postal users and the Postal Service in accordance with the policies of title 39, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that (A) either improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or enhance the performance of mail preparation, processing, transportation, or other functions; and (B) do not cause unreasonable harm to the marketplace.”

This is a new ratemaking factor under the PAEA. The PAEA provides a statutory foundation for negotiated service agreements, eliminates the need for advance, on-the-record

⁴¹ See former 39 U.S.C. §§ 3623(c)(3) and (4).

hearings and review, and significantly expands the bases for such agreements, which under the PRA were permitted in only limited circumstances and following often lengthy litigation. NSAs that result in a net gain in contribution were permitted under the PRA. Section 3622(c)(10) also permits NSAs which “enhance the performance of mail preparation, processing, transportation, or other functions.” Thus, NSAs can serve as vehicles to promote reduced costs and improved efficiency to ensure the continuation of universal, affordable, mail service. The Commission’s regulations should expand opportunities for traditional NSAs and should encourage and promote NSAs that extend the benefits of these strategic partnerships to smaller-volume mailers thereby democratizing the benefits of NSAs.

The regulations addressing rate adjustment procedures should revisit the existing NSA regulations to facilitate expedited implementation of NSAs consistent with the new statutory recognition of NSAs.⁴² As discussed above, the regulations governing special classifications must appropriately address issues of confidentiality and commercial sensitivity and must distinguish between the notice of generally applicable rate adjustments and rate adjustments in connection with special classifications.

k. ESCI

Section 3622(c)(11) requires the Commission to take into account the “educational, cultural, scientific, and informational value to the recipient of mail matter.”

This statutory factor recodifies without change a previous PRA provision.⁴³

⁴² See 39 C.F.R. §§ 3001.190-198.

⁴³ See former 39 U.S.C. § 3622(b)(8).

l. Network Efficiencies

Section 3622(c)(12) requires the Commission to take into account the “need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services.”

This is a new ratemaking factor under the PAEA.

It is likely that cost reductions and efficiency enhancements in connection with the rationalization of the Postal Service’s network will be addressed in a separate proceeding.⁴⁴ This factor, however, demonstrates Congressional interest in efficiency and cost reduction. As discussed above, the modern ratemaking system should maximize productive efficiency and minimize the total costs for the postal sector. This is a paramount objective of the PAEA and is necessary to grow the mail, enhance the value of the mailstream, and ensure universal, affordable, mail service.

m. Intelligent Mail/ SIM

Section 3622(c)(13) requires the Commission to take into account the “value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail.”

This is a new ratemaking factor under the PAEA.

The modern ratemaking system regulations should promote the continued investment in technology that increases the value of the mail to senders and recipients and improves the efficiency and reduces the costs of the postal system. The regulations should likewise promote *intelligent mail* as a means to facilitate “seamless acceptance”⁴⁵ and enhanced visibility into the

⁴⁴ Section 302 of the PAEA (not included in Title 39) requires the Postal Service, within six months of the establishment of the service standards under Section 3691 of the PAEA, to work in consultation with the Commission to develop a “Postal Service Plan.” Among other issues the Postal Service Plan shall include a description of the “long-term vision of the Postal Service for rationalizing its infrastructure and workforce”

⁴⁵ “Seamless acceptance” refers to the Postal Service’s strategy to streamline all processes related to business mail acceptance, including documentation, scheduling, payment, and entry. The Postal Service’s Transformation Plan

mailstream. Potential track/trace capability for all mail pieces, including single piece mail, will bring a level of transparency to the mailstream that will help mailers manage customer relationships, cash flow, and operations. This visibility increases the value of the mail and promotes growth in mail volume. *Intelligent mail* will also help the Postal Service measure service, ensure compliance with service standards, improve operational efficiency, and reduce costs.

The PAEA also recognizes mail security in both a statutory ratemaking objective and a factor. The Commission’s regulations should encourage the Postal Service to use pricing to incentivize enhanced mail security. The regulations should further encourage the Postal Service to promote technology that facilitates SIM as a means of reducing security-related mail processing costs. The Postal Service should also be encouraged to use its pricing authority to incentivize more mailers to send secure mail that uniquely identifies the sender of the mail piece and uniquely identifies the mail piece. The regulations should also encourage the Postal Service to promote the use of technology to prevent revenue fraud.

n. Catch All

Section 3622(c)(14) provides that in establishing the modern ratemaking system for market dominant products the Commission shall take into account the “the policies of this title as well as such other factors as the Commission determines appropriate.”

This statutory factor combines and recodifies previous PRA provisions.⁴⁶ In the past, “policies of this title” was construed to include relevant considerations under sections 101, 403, and 404. Under the PAEA, the new policies of section 404a, relating to unfair competition, must

includes a stated goal to move to a totally electronic system that allows customers to transact all of the business of entering mail without the need to submit paper documentation.

⁴⁶ See former 39 U.S.C. §§ 3622(b), 3622(c)(10).

also be taken into account. The direction that the Commission take into account “policies” beyond those stated in provisions of chapter 36 relating to the establishment of a modern ratemaking system supports a continuing active role for the Commission under the modern ratemaking system.

C. WORKSHARE

Section 3622(e) defines and recognizes worksharing in statute while at the same time imposing limitations on workshare discounts and subjecting the Postal Service to increased reporting requirements.

Section 3622(e)(1) defines the term “workshare discount” as a “rate discount provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission.”

Section 3622(e)(2) provides that subject to certain enumerated exceptions, the Commission shall ensure that workshare discounts not exceed the Postal Service’s avoided costs. The limitation and enumerated exceptions are generally consistent with the Commission’s long-held support for cost-based rates and application of the theory of ECP. The limitation on workshare discounts is consistent with ECP because discounts in excess of the per unit costs avoided of the Postal Service may encourage some mailers to take advantage of the discount even though they cannot perform the service as inexpensively as the Postal Service.

The PAEA recognizes, however, that this is not a categorical prohibition. Rather, the Postal Service is afforded the flexibility to establish discounts in excess of costs avoided in special circumstances relating to a “new postal service” or “new workshare initiative,” *see* 39 U.S.C. § 3622(e)(2)(A)(i), when necessary for a limited duration as a means to “to induce mailer behavior that furthers the efficient operation of the Postal Service,” *see* 39 U.S.C. § 3622(e)(2)(A)(ii). The Postal Service is also afforded the pricing flexibility to establish

discounts above costs avoided for a limited duration to “mitigate rate shock.” *See* 39 U.S.C. § 3622(e)(2)(B). Similarly discounts above costs avoided are permitted for mail consisting exclusively of educational, cultural, scientific, or informational value. *See* 39 U.S.C. § 3622(e)(2)(C). Discounts above costs avoided are also permitted where a “reduction or elimination of the discount would impede the efficient operation of the Postal Service,” *see* 39 U.S.C. § 3622(e)(2)(D). The general limitation is also subject to a broad exception where the reduction or elimination of a workshare discount would “lead to a loss of volume in the affected category . . . and reduce the aggregate contribution to the institutional costs of the . . . category subject to the discount,” *see* 39 U.S.C. § 3622(e)(3)(A), or where the result of such reduction or elimination would “result in a further increase in the rates paid by mailers not able to take advantage of the discount,” *see* 39 U.S.C. § 3622(e)(3)(B).

Moreover, in implementing this section the Commission must take care that this limitation does not result in a one-way street. Just as workshare discounts should generally not exceed avoided costs, neither should workshare discounts fail to pass through, to the extent practicable, the full measure of costs avoided. In addition to enforcing the statutory limitation on workshare discounts, consistent with the theoretical principles of ECP and the overall statutory framework of the PAEA, the Commission’s regulations should require the Postal Service to establish discounts that reflect the full measure of workshare-related costs avoided to the extent practicable.

The Commission should address the specific exceptions and limitations under section 3622(e)(2) and (3) on a case-by-case basis.

Finally, the Commission regulations should require the Postal Service to satisfy the reporting requirements under 3622(e)(4) at the same time it provides the underlying cost data and information to support its notice of rate adjustment under 3622(d).

III. COMPETITIVE PRODUCTS

Although the majority of the ANPRM addresses the modern ratemaking system for market-dominant products, the ANPRM also touches briefly on several important aspects of subchapter II of chapter 36 regarding the provisions relating to competitive products.

Specifically the ANPRM cites to the three component parts of section 3633(a). Section 3633(a)(2) requires that “each competitive product cover its costs attributable.” For purposes of subchapter II of chapter 36, “costs attributable” is a defined term which means “the direct and indirect postal costs attributable to such product through reliably identified causal relationships.” 39 U.S.C. § 3631(b). Section 3633(a)(1) is derivative of section 3633(a)(2) insofar as it prohibits “the subsidization of competitive products by market dominant products.” The Commission’s regulations should clarify that a subsidy in this context means that a product is priced below its “costs attributable.” The minimum cost contribution for institutional costs discussed below is thus not properly included in the calculation of a subsidy.

Section 3633(a)(3) touches upon the important issue of what share of the institutional costs of the Postal Service must be borne by competitive products. This is an issue that is also raised by the statutory objectives for the modern ratemaking system governing market dominant products (section 3622(b)(9)) as well. Rather than prescribe a specific share, the PAEA charges the Commission with identifying an “appropriate share” or allocating the total institutional costs “appropriately between market dominant and competitive products.” 39 U.S.C. § 3622(b)(9). These are normative judgments. Thus, it is imperative that the Commission regulations appropriately balance the allocation of institutional costs as a matter of fairness to other market

participants while at the same time ensuring that the viability of the Postal Service's competitive product offerings are not undercut by overburdening them with institutional costs.

The Commission has substantial experience in the area of assigning institutional costs among postal products.⁴⁷ Accordingly, the assignment of institutional costs recommended by the Commission in connection with the last rate case, Docket No. R2006-1, should serve as a baseline or default position for allocating institutional costs between the market dominant and competitive products under the PAEA.

Section 3633(b) provides for a periodic review and adjustment every five years based on prevailing competitive conditions and costs to assess whether the minimum institutional cost contribution requirements under section 3633(a)(3) should be "retained in its current form, modified, or eliminated." 39 U.S.C. § 3633(b).

IV. CONCLUSION

In the Postal Accountability and Enhancement Act Congress provided only the framework for the modern system of ratemaking. It delegated substantial responsibility to the Postal Regulatory Commission to "by regulation . . . establish a modern system for regulating rates and classes for market dominant products" and "to bound Postal Service discretion in setting rates for competitive postal products." As explained above, in fulfilling these responsibilities Pitney Bowes urges the Commission, in the regulations that eventually result from this proceeding, to provide comprehensive guidance as to the requirements and boundaries of the new system. In doing this the Commission must ensure that the modern ratemaking system *achieves* the statutory *objectives*, *takes into account* the enumerated *factors*, and *satisfies* the statutory *requirements*.

⁴⁷ Former 39 U.S.C. § 3622(b)(3) required the Commission to determine the portion of institutional costs "assignable" to each class of mail or type of mail service.

Above all, the Commission must further the congressional objective “to reduce costs and increase efficiency.” This will ensure a vibrant, growing mailing industry and continuing universal, affordable mail service. As discussed above, the Commission can do this by building upon its decisions recognizing the importance of Efficient Component Pricing. This will ensure that postal rates for market dominant products, to the maximum extent practical, reflect Postal Service costs and will minimize total costs for the postal sector.

At the same time, the Commission must balance the statutory objective of rate stability and predictability with that which commands it to allow the Postal Service pricing flexibility. This can be achieved, as explained above, through implementation of the required annual limitation on rate increases coupled with regulations giving the Postal Service the pricing flexibility the PAEA allows.

Pitney Bowes urges the Commission to develop a modern ratemaking system that encourages the Postal Service to promote and enhance the value of mail as a vital communications medium for senders and recipients. As explained above, this should be achieved through requirements and incentives that promote technology such as *intelligent mail* and sender-identified mail. This will ensure a more secure, information-rich, and valuable mailstream furthering continued universal, affordable mail service.

With respect to its regulations governing workshare discounts, the Commission should take care that it not deter, through overly prescriptive rules, the economic efficiency that results from worksharing. Consistent with the Efficient Component Pricing Rule, the PAEA provides that workshare discounts, generally, should not exceed costs avoided. The PAEA provides several grounds for exception to this rule, and the Commission should address these exceptions on a case-by-case basis.

